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March 18, 2008

AGENDA ITEM 4-A

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

I. SUBJECT: Assembly Bill 1844 (Hernandez)—As Introduced January 28, 2008

Public Employees Benefits

II. PROGRAM: Legislation

III. RECOMMENDATION: Support

This bill would increase transparency and accountability of pension and Other Post-Employment Benefit (OPEB) funding, and enhance CalPERS' ability to respond to instances of disability fraud.

IV. ANALYSIS:

This proposal addresses recommendations from the Governor's Public Employee Post-Employment Benefits Commission (Commission) that strengthens governance and increase transparency and accountability. This bill would make it a crime to file a fraudulent claim for a retirement or disability benefit, and would provide CalPERS greater access to employment and investigatory information maintained by the Employment Development Department or workers' compensation insurers. These changes enhance CalPERS' administrative authority and ability to respond to instances of fraud.

This bill increases transparency and accountability by requiring public agencies to report OPEB information to the State Controller, and requires the State Controller to develop a simple and inexpensive procedure to collect and report this information. In addition, before authorizing increases in public retirement plan benefits, this bill requires the actuary's statement of the actuarial impact upon future annual costs to include normal cost and any additional accrued liability, and that the agency chief executive officer attest in writing that he or she understands the current and future costs.

Background

Public Employee Post-Employment Benefits Commission

Governor Arnold Schwarzenegger signed an Executive Order in December 2006 to create a 12-member panel to identify financial liabilities that California's public agencies and school systems face in paying pension and health care benefits for retiring employees.

On January 7, 2008, the Commission issued its comprehensive report containing 34 recommendations divided into 8 groups that addressed the unfunded pension and retiree health care liabilities for California state and local governments. The recommendations are a culmination of 10 months of work by the bipartisan commission, including nearly 100 hours of testimony received from policy experts, concerned citizens, governmental leaders, and public union representatives.

The recommendations are designed to help state and local leaders fulfill promises made to provide pensions and Other Post-Employment Benefits to the state's public workforce with sensible fiscal policies, allowing for long-term cost savings. The Commission is also calling for frequent and direct communication with employees and retirees about benefit availability and modifications. In addition, several recommendations were made to increase openness, transparency, and accountability throughout the benefits process.

Retirement Program

When a member retires they typically do so under one of the following three scenarios:

- A normal service retirement, where the member has reached the minimum retirement age and vesting requirement prescribed by their retirement benefit formula.
- A disability retirement, where a member's injury or illness does not need to be related to their employment but must meet a minimum age and vesting requirement (established by the member's retirement benefit formula) to maximize their monthly benefit.
- An industrial disability retirement, where a member in a specific classification (school, local or state safety, state patrol member, etc.) whose injury or illness is job-related, may receive 50 percent of his or her final retirement benefit tax-free.

The use of the disability program has raised a variety of concerns among CalPERS' members, employers, elected officials, and the general public. Specifically, there are concerns that the disability program has been abused by a narrow segment of members.

In 1994, legislation (SB 1480, Russell) was introduced to address instances of disability fraud by providing penalties for making false statements in connection with an application for retirement benefits. SB 1480 was similar to legislation enacted two years earlier amending the Insurance Code to specifically make it a crime to defraud the workers' compensation insurance program. SB 1480 failed passage in the Legislature.

On August 3, 2004, the California Performance Review (CPR) released its report on reforming California's state government. In recommendation PS11, the CPR suggested changing existing laws to assist CalPERS' investigation unit with the prosecution of disability fraud. Specifically, the CPR recommended statutory changes to clearly define what constitutes disability retirement fraud.

In the 2005 legislative session, CalPERS sponsored legislation to address the CPR's suggested changes to existing laws. However, these bills failed to meet the legislative deadlines. In November 2006, the Board again agreed to sponsor legislation but it was not introduced pending the outcome of the Commission.

In January of this year, the Commission further reinforced this idea with Recommendation 26 of its report to the Legislature. This bill is a result of these findings.

Proposed Changes

This proposal has five main provisions; two deal with enhanced governance while the other three address increase accountability and transparency.

Specifically, this bill:

- Establishes a definition of, and penalties for, fraud when done so in connection with benefits, or an application for benefits, administered by CalPERS, CalSTRS or '37 Act County System.

- Allows CalPERS' investigators increased access to information maintained by the Employment Development Department or by the workers' compensation insurers with respect to an investigation of benefit eligibility or unlawful application for, or receipt of benefits.

- Requires public agencies that provide OPEBs to report specified information to the State Controller. Also requires the State Controller to develop a simple and inexpensive procedure to collect and report this information.

- Requires the State Controller to publish its annual report on the financial condition of all state and local public retirement systems within 12 months of the receipt of the information, and in no case later than 18 months after the end of the fiscal year upon which the information in the report is based.

- Requires that the Enrolled Actuary's cost analysis include normal cost and any additional accrued liability. The agency chief executive officer shall attest in writing that he or she understands the current and future costs of any increased retirement benefit.

Legislative History

2006 AB 36 (Niello) – Would have established a definition of, and penalties for, fraud when done so in connection with benefits, or an application for benefits, administered by CalPERS, CalSTRS or ’37 Act County Systems.

AB 545 (Walters) – Would have allowed CalPERS investigators increased access to information maintained by the Employment Development Department (EDD) or by workers’ compensation insurers with respect to an investigation of benefit eligibility or unlawful application for, or receipt of, benefits.

2005 AB 456 (Torrico) – Would have established a definition of, and penalties for, fraud when done so in connection with benefits, or an application for benefits, administered by CalPERS. Similar provisions were introduced in ABX1 5 during special session. The bill died in the Assembly. *CalPERS position: Sponsor.*

SB 697 (Kuehl) – Would have allowed CalPERS’ investigators increased access to information maintained by the Employment Development Department (EDD) or by workers’ compensation insurers with respect to an investigation of benefit eligibility or unlawful application for, or receipt of, benefits. Similar provisions were also introduced in SBX1 4 during special session. This content was removed from the bill on 8/17/06. *CalPERS’ position: Sponsor (introduced version).*

1994 SB 1480 (Russell) – Would have specifically required the Board to adjust or cancel retirement benefits if the member engaged in fraud to obtain those benefits, and set forth the punishment for any person convicted of such fraud. This bill was modeled after SB 1218, (Chapter 116, Statutes of 1991), which amended the Insurance Code to specifically prohibit workers’ compensation fraud. The bill died in the Assembly. *CalPERS’ position: Sponsor.*

1993 Chapter 1297 (SB 53, Russell) – This bill was the culmination of stakeholder efforts to eliminate the inappropriate inflation of retirement benefits by clearly defining compensation and special compensation that can be used for the purposes of calculating a member’s retirement benefit. *CalPERS’ position: Sponsor.*

1991 Chapter 116 (SB 1218, Presley) – This bill amended the Insurance Code to specifically prohibit workers' compensation fraud and specify penalties for such fraud. *CalPERS' Position: None.*

1978 Chapter 388 (SB 1619, Johnson) – Made minor changes in Chapter 928 that eased the reporting burden on public pension plans. *CalPERS' Position: Support.*

1977 Chapter 928 (AB 727, McAlister) – This bill required each state and local agency which maintains a retirement plan to annually submit audited financial statements to the SCO and to triennially secure the services of an enrolled actuary, require the SCO to establish an advisory committee, and require the SCO to annually compile and publish a report. *CalPERS' Position: Oppose*

Issues

1. Arguments in Support

   According to the Chair, the Commission developed recommendations which are meant to facilitate compliance with the new reporting standards for Other Post-Employment Benefits, to ensure the fiscal integrity of California's pension systems, and to hold all public agencies to a standard of best practices in finance, disclosure, deferred compensation structure, and budget priorities.

2. Arguments in Opposition

   There is no known opposition at this time.

3. Definition of Fraud & Penalty for Fraud

   The Public Employees' Retirement Law fails to clearly define fraud when committed in connection with an application for retirement benefits, and fails to provide clear penalties for such fraud. As noted in recommendation PS11 of the CPR, there is no statute which defines as fraud those activities associated with a member's fraudulent application for retirement and no clear penalties for such fraud. This proposal corrects that oversight by adding a new statute modeled after an Insurance Code statute defining workers' compensation fraud and the penalties associated with such fraud.

4. Limited Inter-Agency Cooperation

   CalPERS' investigators are currently hampered by a statute which fails to grant them access as peace officers to employment information retained by other state agencies (e.g., Employment Development Department) in connection with an investigation. This information could significantly assist investigators in determining who is receiving a disability retirement benefit while working for another employer. The current system used by CalPERS' investigators relies on audits of disability retirements, and third-party whistleblowers.

5. Standardized process/guidelines for collecting OPEB information

   Currently the State Controller's Office collects very precise financial and actuarial data from all public retirement systems and issues a report on the financial condition of all state and local public retirement systems. In contrast the Commission found that there does not exist a similar process to collect and publish OPEB information from public agencies. As public agencies and policy makers continue to address OPEB issues, it could be quite helpful to have a common site to accept and report OPEB-related data from.

6. Legislative Policy Standards

   CalPERS' Legislative Policy Standards suggest a support position for proposals developed through a collaborative effort where the opinions of all relevant stakeholders are considered. This bill is a result of recommendations from a bipartisan commission that would increase transparency and accountability of pension and Other Post-Employment Benefit (OPEB) funding and enhance CalPERS' ability to respond to instances of disability fraud. Therefore, staff recommends the Board support AB 1844.

V. STRATEGIC PLAN:

This item is not a specific product of the Annual or Strategic Plans, but is a part of the regular and ongoing workload of the Office of Governmental Affairs.

VI. RESULTS/COSTS:

The two enhanced governance proposals do not mandate any additional enforcement activity on CalPERS, but rather provides additional enforcement tools and a level of deterrence. The other three provisions dealing with increased transparency do not have a direct impact on program or administrative costs.

Program Cost

The fraud definition and access to investigatory information proposals are expected to reduce program costs as a result of reducing the number of fraudulent disability retirements by providing a deterrent for making fraudulent statements. The reduction in costs is entirely dependent upon deterring fraudulent use of the disability program and removing members from the retirement benefit rolls when they are no longer disabled.

Administrative Costs

It is anticipated that any additional administrative costs should be minimal and absorbable. The goal of this bill is to reduce fraudulent applications through deterrence and provide staff with additional enforcement tools.

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